

Service Date: June 30, 1988

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Application)	UTILITY DIVISION
of MOUNTAIN WATER COMPANY for)	
Authority to Increase Rates and)	DOCKET NO. 87.9.50
Charges for Water Service in the)	
Superior, Montana Service Area.)	ORDER NO. 5314a

FINAL ORDER

APPEARANCES

FOR THE APPLICANT:

John Alke, Attorney at Law, Hughes, Kellner, Sullivan & Alke,
P.O. Box 1166, Helena, Montana 59624

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34 West
Sixth Avenue, Helena, Montana 59620

FOR THE COMMISSION:

Robin McHugh, Staff Attorney, 2701 Prospect Avenue, Helena,
Montana 59620

Ron Woods, Rate Analyst, 2701 Prospect Avenue, Helena, Montana
59620

BEFORE:

HOWARD ELLIS, Commissioner and Hearing Examiner

BACKGROUND

On September 30, 1987, Mountain Water Company (Applicant or MWC) filed an application with this Commission for authority to increase water rates for its Superior, Montana customers on a permanent basis by approximately 78.5 percent which constitutes an annual revenue increase of approximately \$45,021.

Concurrent with its filing for a permanent increase in rates MWC filed an application for an interim increase in rates of 40.0 percent equalling a revenue increase of approximately \$22,923 or 51 percent of the proposed permanent increase.

On December 15, 1987, the Commission having considered the merits of the Applicant's interim application, issued Order No. 5314 granting the Applicant's request for interim rate relief.

On February 28, 1988, following issuance of proper notice, a hearing was held in the 4-H Building, Superior, Montana.

The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustments. At the close of the public hearing the parties stipulated to allow the Commission to issue a final order in this Docket.

The year ending December 31, 1986, is the test year in this application. The Commission finds this to be a reasonable period

within which to measure the Applicant's utility revenues, expenses, and returns for the purpose of determining a fair and reasonable level of rates for water service.

FINDINGS OF FACT

At the public hearing the Applicant presented the testimony and exhibits of:

Lee Magone, Vice President and General Manager, MWC
Don Cox, Certified Public Accountant.

No public testimony was received during the course of the hearing but the parties agreed to leave the record open for a period of two (2) weeks to allow for the filing of written comments by subscribers.

MWC requested that the Commission, for purposes of this Order, adopt some of the findings contained in this Commission's Order No. 5252b. Order No. 5252b is the decision rendered June 30, 1987, by this Commission, on MWC's request for increased rates in its Missoula Division. MWC asserts that the findings in Order No. 5252b regarding the following items should be adopted:

- 1) Capital Structure
- 2) Cost of Debt
- 3) Cost of Equity
- 4) Overall Rate of Return

The items enumerated in the previous finding are financial issues that are not subject to change between the Missoula and Superior operating divisions of MWC. The Commission finds the Applicant's request to adopt findings from Order No. 5252b, regarding the above listed items, to be reasonable. The following Findings of Fact regarding the previously enumerated issues are taken directly from Order 5252b.

CAPITAL STRUCTURE

In its application MWC proposed the following capital structure for rate case presentation:

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>
Equity	\$5,996,914	66.75%
Debt	<u>\$2,987,500</u>	<u>33.25%</u>
	\$8,984,414	100.00%

As part of the stipulation entered into between the Applicant and the Montana Consumer Counsel (MCC), the Applicant agreed to the use of a hypothetical capital structure to determine its composite cost of total capital. The Applicant and the MCC agreed to the use of a 50/50 debt-equity ratio for purposes of calculating the following capital structure:

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>
Equity	\$4,492,207	50.00%
Debt	<u>\$4,492,207</u>	<u>50.00%</u>
	\$8,984,414	100.00%

The Commission, for the reasons stated in its Order No. 5252a, found that use of the stipulated capital structure as presented in Finding of Fact No. 13 is reasonable in this instance.

The stipulated capital structure will be used to calculate the composite cost of total capital in this Docket.

COST OF EQUITY

The Applicant originally requested that the Commission authorize a 13.5 percent return on equity. As part of the stipulation between the Applicant and the MCC, the Applicant agreed to reduce its requested return on equity from 13.5 percent to 13.0 percent.

The stipulated return on equity was not a contested issue during the public hearing in this Docket. As indicated by the Findings of Fact in Order No. 5252a, the stipulated return on equity is within the range of the returns recently authorized by this Commission for other utilities under its jurisdiction. The 13.0 percent return on equity stipulated to by the Applicant and the MCC will be used in this order for purposes of determining MWC composite cost of total capital.

COST OF DEBT

The debt capital of the Applicant consists of a \$2,987,500 note issued by Park Water Company to Montana Power Company. This debt is an obligation of Park Water Company rather than its subsidiary, MWC, but the note has been properly assigned to the Applicant for ratemaking purposes.

The cost of debt, or interest, on this note is variable, the present cost being 9.25 percent and the cost at maturity being 10.0 percent. The cost of debt presented by the Applicant was not challenged by any party participating in this proceeding and is accepted by the Commission.

CAPITAL STRUCTURE AND COMPOSITE COST OF TOTAL CAPITAL

The Commission finds the following capital structure and composite cost of total capital to be reasonable:

<u>Description</u>	<u>Amount</u>	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Equity	\$4,492,207	50.0%	13.00%	6.500%
Debt	\$4,492,207	50.0%	9.25%	4.625%
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	\$8,984,414	100.0%		
Composite Cost of Total Capital				11.125%

RATE BASE

In its application MWC proposed an average original cost depreciated rate base of \$238,157. The rate base calculation presented by the Applicant was not challenged by any party participating in this proceeding and is accepted by the Commission.

OPERATING REVENUE

The Applicant proposed test period operating revenues of \$57,308. The Applicant for the most part provides water service on an unmetered basis, therefore, water consumers are assessed a flat fee for services provided. Since the Applicant collects the vast majority of its water charges by assessment of a flat fee it is very easy for the Applicant to calculate operating revenues. The Applicant's calculated test period operating revenues were not a contested issue and are accepted by the Commission.

OPERATING EXPENSES

The Applicant proposed total test period operation and maintenance expenses of \$47,913. The test period operation and maintenance expense proposed by the Applicant includes proforma adjustments increasing expenses by \$7,070.

The proposed adjustments increasing MWC's operating expenses were fully explored during the course of this proceeding.

The proposed adjustments are found to be reasonable and the Commission accepts the Applicant's test period operation and maintenance expense of \$47,913.

The Commission finds the Applicant's depreciation expense to be \$7,149.

Taxes other than income are found to be \$13,438.

INCOME TAXES

There was controversy surrounding the appropriate income tax expense in this Docket. The controversy centered around the ratemaking treatment that should be afforded net operating loss carry forwards (NOL). Under the Internal Revenue Code NOL's can be used to offset taxable income on a dollar for dollar basis, thus reducing the income tax liability of the taxpayer.

At the hearing the MCC and the Applicant resolved this controversy to their satisfaction, by stipulating that, for purposes of this hearing, MWC would reduce tax expense by including the effect of NOL's in the income tax calculation for the Superior Division. Although MWC does not agree that NOL's should be reflected, it entered into the stipulation. MWC's agreement to stipulate the issue was predicated on an understanding that the decision in its pending court challenge of this Commission's decision regarding proper ratemaking treatment for NOL's, would be binding in this Docket.

The Commission concurs in the stipulation entered into between the parties, and finds that NOL's should be reflected in the calculation of income tax expense. The Commission further finds that the district court ruling, from MWC's court challenge of this Commission's decision regarding proper ratemaking treatment for NOL's should be binding. If the court rules that NOL's should not be used to reduce the utility's income tax expense the Applicant is authorized to file increased rates sufficient to recover the full tax expense calculated in this docket.

REVENUE REQUIREMENT

Based on the Findings of Fact contained herein, the Commission finds that in order to produce a rate of return of 11.125 percent on MWC's average original cost depreciated rate base, the Applicant will require additional annual revenues in the amount of \$43,859 from its Superior, Montana water utility.

The Applicant's accepted test year proforma operating revenues, expenses, and rate of return are summarized as follows:

MOUNTAIN WATER COMPANY - SUPERIOR DIVISION

Computation of Net Income Test Year 1986

				To
Produce	Accepted			
		Present Rates	Test	11.125%
Rate by the			Year	of
Return	Commission	(Company)	Adjustment	
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Operating Revenues	\$ 57,308		\$ 57,308	
\$43,859	\$101,167			
Deductions:				
O&M Expense	\$ 40,843	7,070	\$ 47,913	
	\$ 47,913			
Depreciation	6,353	796	7,149	
	7,149			
Taxes Other Than				
Income	13,375	63	13,438	
162	13,600			
Income Taxes	-0-	285	285	
5,725	6,010			
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Net Income	\$ 3,263		\$ 9,856	
	\$ 26,495			
Rate Base	\$238,157		\$238,157	
	\$238,157			
Return on Rate Base	-1.37%		-4.14	
	11.125%			

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28. Although MWC has demonstrated the need for a revenue increase of \$43,859, it is not proposing to immediately implement rates that are sufficient to generate the additional annual revenue requirement recognized in this Order. To generate the additional annual revenues recognized in this order MWC has proposed to increase rates in three phases, the three phases being; first phase interim rate relief of 40 percent (approved by the Commission on December 15, 1987), second phase a 20 percent increase to be effective December 31, 1988, and the third phase a 16.53 percent increase to be effective December 31, 1989.

The Applicant has proposed a three step phase in of the rate increase to limit the rate shock that will be experienced by consumers connected to the Superior water system. The Applicant recognizes that losses may occur as a result of the phasing in of the rates, but is willing to have the stockholders of the company bear these losses. The Commission finds the Applicant's proposal to phase in rates, in the manner described in the preceding Finding of Fact, to be acceptable.

RATE DESIGN

The Applicant has proposed a uniform percentage increase be applied to the rates and charges of all customer classifications for purposes of generating the increased revenues authorized herein. Absent a cost of service study, the Commission is of the opinion that a uniform percentage increase in rates to all customers classes is the most equitable method of implementing the revenue increase authorized herein and therefore accepts the Applicant's proposal.

CONCLUSIONS OF LAW

1. The Applicant, Mountain Water Company, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's rates and service pursuant to Section 69-3-102, MCA.

2. The Commission has provided adequate public notice and an opportunity to be heard as required by Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.

3. The rates and rate structure approved in this order are just and reasonable. Sections 69-3-201, and 69-3-330, MCA.

ORDER

NOW THEREFORE, IT IS ORDERED THAT:

1. Mountain Water Company shall file rate schedules which ultimately reflect an increase in annual revenues of \$43,859 for its Superior, Montana service area. The increased revenues shall be generated by increasing rates and charges as provided herein.

2. The rates approved herein shall become effective upon Commission approval.

DONE IN OPEN SESSION at Helena, Montana this 30th day of June, 1988, by a vote of 5 -0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Carol Frasier
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.

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MOUNTAIN WATER COMPANY - SUPERIOR DIVISION

Computation of Net Income Test Year 1986

	To Produce Present Rates (Company)	Accepted Test Adjustment	11.125% Year	Rate of Return	by the Commission
Operating Revenues	\$ 57,308	\$ 57,308	\$43,859		\$101,167
Deductions:					
O&M Expense	\$ 40,843	7,070	\$ 47,913		\$ 47,913
Depreciation	6,353	796	7,149		7,149
Taxes Other Than Income	13,375	63	13,438	162	13,600
Income Taxes	-0-	285	285	5,725	6,010
Net Income	\$ 3,263	\$ 9,856	\$ 26,495		
Rate Base	\$238,157		\$238,157		\$238,157
Return on Rate Base	-1.37%			-4.14	11.125%